

ANALYSIS OF AMENDED BILL

Author: Florez and Ashburn Analyst: Nicole Kwon Bill Number: SB 923
 Related Bills: See Legislative History Telephone: 845-7800 Amended Date: March 29, 2005
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT:

Disaster Loss Deduction/Excess Loss Carryover/Loss Sustained On Or After
 January 1, 2005, As A Result Of The West Nile Virus

SUMMARY

This bill would allow taxpayers special tax treatment for losses sustained as a result of the West Nile virus.

This analysis will not address the bill's changes to the Health and Safety Code as they do not impact the department or state income tax revenue.

SUMMARY OF AMENDMENTS

The March 29, 2005, amendments struck the previous provisions relating to unemployment insurance and replaced them with the provisions providing special tax treatment for losses as a result of the West Nile virus.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to intent language in the bill, the purpose of the bill is to provide immediate tax relief to individuals and businesses affected by the West Nile virus.

EFFECTIVE/OPERATIVE DATE

As amended, this bill is an urgency statute and would be effective and operative immediately.

POSITION

Pending.

Board Position:

_____ S _____ NA _____ NP
 _____ SA _____ O _____ NAR
 _____ N _____ OUA _____ X PENDING

Department Director

Date

Gerald H. Goldberg

4/28/05

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal law generally allows taxpayers engaged in a trade or business to deduct all expenses paid or incurred that are considered ordinary and necessary in conducting that trade or business.

Under existing state and federal law, any loss sustained during the year that is not compensated for by insurance or otherwise is allowed as a deduction. The amount of the loss deduction generally is limited to the taxpayer's basis in the property that was lost.

Under existing state tax law, farming businesses directly affected by Pierce's disease and its vectors can carry forward a special net operating loss against affected farming business income to each of the nine taxable years following the loss until used. The loss is not allowed to be carried back to previous tax years.

Under federal and state law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Under federal and state tax law, a taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made for any Presidentially-declared disaster prior to passage of any state legislation allowing special carryover treatment because California conforms to federal law. The election is available for a Governor-only declared disaster only if specific enabling legislation is enacted.

A nonbusiness disaster loss not reimbursed by insurance or otherwise is deductible under both state and federal tax law to the extent of two limitations: threshold amount limitation and adjusted gross income limitation. Under the threshold amount limitation, a nonbusiness disaster loss is deductible to the extent the loss exceeds \$100. Under the adjusted gross income limitation, total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income.

State tax law identifies specific events as disasters that are then allowed additional special loss carry over treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, the remaining loss may be carried over at a specified percentage for up to 10 additional years. The specified percentage is 100% for losses attributable to taxable years beginning on or after January 1, 2004.

BACKGROUND

There were a total of 830 West Nile virus infections reported from 23 counties in California in 2004; of those, 28 resulted in fatalities. There have been no reports of human illness due to West Nile virus in 2005, yet West Nile virus has been detected in 21 California counties in 2005.

THIS BILL

This bill would allow special loss treatment for losses sustained as a result of the West Nile virus on or after January 1, 2005.

By reference to IRC 165, this bill would define the term “excess loss” to mean any loss during the taxable year, not compensated by insurance or otherwise, that exceeds the adjusted taxable income, as defined, for the year of the loss.

This bill would allow the taxpayer to elect to claim the loss either in the year the loss occurred or in the year preceding the loss.

This bill would allow 100% of any excess loss to be carried over for five years. Any remaining excess loss would be carried forward under existing law for an additional 10 years.

IMPLEMENTATION CONSIDERATIONS

This bill would allow a special loss treatment for losses sustained as a result of West Nile virus. However, it is not clear what constitutes a loss resulting from West Nile virus or how the department would be able to establish or verify that West Nile virus was responsible for the loss. As a result, this bill would be difficult to administer and could lead to disputes between taxpayers and the department.

It appears that the authors’ intent was to provide treatment similar to that of disaster losses. However, disaster loss treatment typically identifies a period during which the loss is sustained and may be eligible for special disaster loss treatment. This bill would allow any specified loss sustained on or after January 1, 2005, to receive the special loss treatment.

Current law provides a special net operating loss deduction for taxpayers impacted by Pierce’s disease. Pierce’s disease affects farmers and their crops. This special net operating loss deduction is limited to losses resulting from the business of farming and is only allowed if the Department of Food and Agriculture verifies the reason for the loss. The author may wish to pursue a similar statute for taxpayers that suffer a loss as a result of West Nile virus.

LEGISLATIVE HISTORY

AB 238 (Rod Pacheco, Stat. 2001, Ch. 623) allows special net operating loss treatment to losses sustained by farmers as a result of Pierce’s disease and its vectors.

AB 2170 (Rod Pacheco, 1999/2000) would have allowed special net operating loss (NOL) treatment for losses sustained by a farmer as a result of pest infestations. This bill failed passage in the Assembly Appropriations Committee.

AB 2435 (Thompson, 1999/2000) would have allowed taxpayers a 100% credit equal to the grape crop losses sustained by a grapevine grower because of the Glassy-Winged Sharpshooter pest or Pierce’s Disease. This bill failed to pass the Assembly Committee on Agriculture.

OTHER STATES' INFORMATION

Michigan, Minnesota, Massachusetts, and New York conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss. It appears that legislation, executive order, or proclamation by the President or the Governor is required to identify the area impacted by a disaster that is eligible for federal or state assistance.

Florida does not have a personal income tax; however, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. Florida also requires legislation, executive order, or proclamation to identify the area impacted by a disaster.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue loss from this bill is as follows:

Estimated Revenue Impact of SB 923 Amended March 29, 2005 Assumed Enactment Date After 6/30/05 Fiscal Year Impact \$ In millions		
2005-06	2006-07	2007-08
-\$300	-\$300	-\$300

Revenue Discussion

The language in this bill could allow broad application of the special loss treatment for losses that are even remotely related to West Nile virus. Assuming that all possible losses can be considered eligible under this bill, it is estimated that 6%, or \$3.5 billion, of losses in the current year will be used to offset income in the prior year. Based on preliminary data for the 2003 tax year, net losses for businesses were almost \$58 billion ($\$58 \text{ billion} \times 6\% = \3.5 billion). Applying an average tax rate of 8.5% would result in the revenue loss of approximately \$300 million annually ($\$3.5 \text{ billion} \times 8.5\%$).

ARGUMENTS/POLICY CONSIDERATIONS

Generally, disasters are required to be declared by the Governor or the President to receive special disaster loss treatment. This bill would attempt to provide the same treatment but without the state or federal executive requirement.

Disaster loss treatment typically identifies a period of time in which the loss is sustained and may be eligible for special disaster loss treatment. This bill is written to allow any loss sustained on or after January 1, 2005, to receive the special loss treatment. Therefore, this bill would allow the loss to be carried forward until completely used, creating a precedent.

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